

Weekly Insight

Real GDP surges 4.6% YoY in 2Q19

Key messages of the today's comments

TUESDAY, 20 AUGUST 2019

Domestic liquidity and bonds market

Demand for bills declined

Last week, the MoF did not accept all demand for the bills they offered, borrowing just UAH2bn (US\$80m), but continued to decrease cut-off rates. We expect demand will increase this week, although remain moderate, as investors will wait for the five-year note next week.

Liquidity under pressure from taxes

Last week, outflows from Treasury accounts increased, exceeding budget expenditures. This caused a decline in liquidity below UAH100bn (US\$4bn). We expect it will stay below this level this week.

Foreign exchange market

Hryvnia holds position

The hryvnia exchange rate continued to be volatile inside the expected range, receiving support from exporters and other Ukrainian companies that sold hard currencies to pay income tax. This week, this source will be replaced by foreign investors when they buy three-year notes, although we doubt this will strengthen the hryvnia significantly. We expect the exchange rate to be largely unchanged within the range of UAH25.1–25.5/US\$

Economics

Real GDP surges 4.6% YoY in 2Q19

2Q19 economic growth was the highest since 4Q16 and beat both our and consensus forecasts. Real GDP growth will slow in 2H19 but will likely exceed our 2019 full-year forecast of 2.7% growth.

Banks' reserves market (19 August 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|------------------------------|--------|----------------|-------------|
| NBU rate (%) ¹ | 17.00 | +0bp | -50bp |
| ON rate (%) | 15.78 | -23bp | -108bp |
| ON \$ swap (%) | 14.92 | +55bp | -107bp |
| Reserves (UAHm) ² | 52,845 | -6.33 | +11.00 |
| DepCerts (UAHm) ³ | 45,788 | -1.20 | +0.00 |

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds.
Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (19 August 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|----------------------|----------------|----------------|--------------|
| NBU | 337,066 | -0.01 | -3.17 |
| Banks | 338,881 | +0.14 | -8.04 |
| Residents | 25,803 | -0.95 | +23.11 |
| Individuals | 9,592 | +1.64 | +140.78 |
| Non-res ⁴ | 87,648 | +0.70 | +1,065.94 |
| Total | 798,989 | +0.12 | +6.65 |

Notes: [1] non-residents
Source: NBU, ICU.

FX market indicators (19 August 2019)

| | Last | Weekly chg (%) | YTD chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 25.1850 | +0.16 | -9.47 |
| EUR/USD | 1.1078 | -1.02 | -3.15 |
| DX ² | 98.347 | +0.80 | +2.34 |
| UAH TWI ³ | 131.708 | +0.86 | +12.18 |

Notes: [1] UAH trade-weighted index.
Source: Bloomberg, ICU.

Gov't bond quotes¹ (20 August 2019)

| Maturity | Bid | Ask |
|----------|-------|-------|
| 6m | 17.50 | 16.00 |
| 12m | 17.75 | 16.25 |
| 2y | 17.75 | 16.25 |
| 3y | 17.75 | 16.25 |
| 12m (\$) | 6.75 | 5.25 |
| 2y (\$) | 7.25 | 5.85 |

Notes: [1] Actual quotes you can see at www.icu.ua.
Source: ICU.

Domestic liquidity and bonds market

Demand for bills declined

Last week, the MoF did not accept all demand for the bills they offered, borrowing just UAH2bn (US\$80m), but continued to decrease cut-off rates. We expect demand will increase this week, although remain moderate, as investors will wait for the five-year note next week.

At the previous auction, all bills received less demand than was offered for each issue, but some bids were rejected with the cut-off rate decrease. Budget proceeds amounted to UAH2bn, mostly from the two-year bills. More details in the [auction review](#).

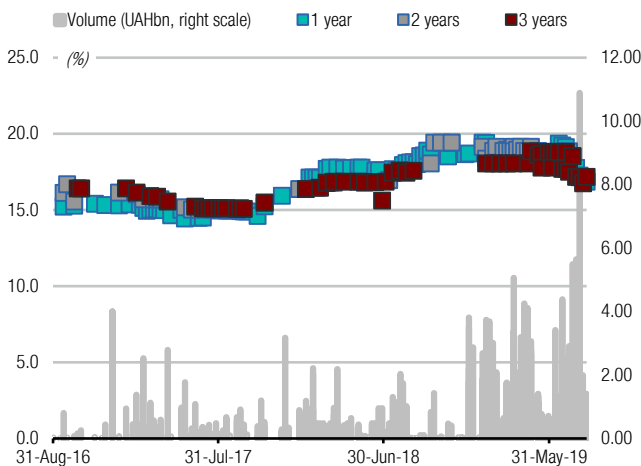
After bond settlement on Wednesday, nearly half had been sold to foreign investors, although the total amount of their portfolios was largely unchanged, as foreigners sold bills in prior auctions. Likely, some of this selling was to raise funds to invest in 2-year bills.

ICU view: This week, we expect a slight decline in foreign investors' portfolios, which will be compensated after auction settlement. Demand at the auction looks to be larger than last week, probably above the offered amount, but will be concentrated in the three-year bills. We do not anticipate significant movement in rates, with the three-month and 11-month left largely unchanged. We expect the cut-off rate for the three-year note to slide by about 10bp to around 16.1%.

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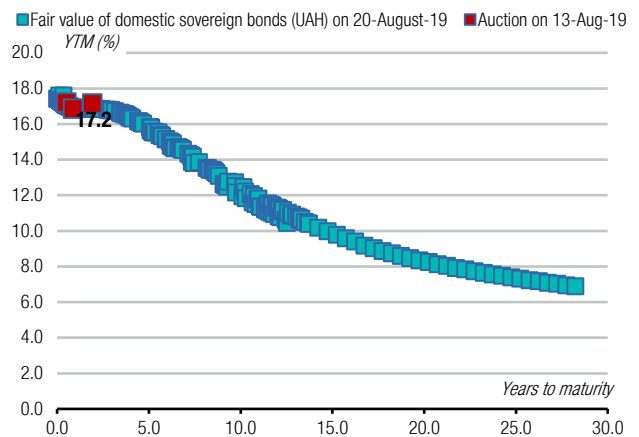
Chart 1. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: Ministry of Finance of Ukraine, ICU.

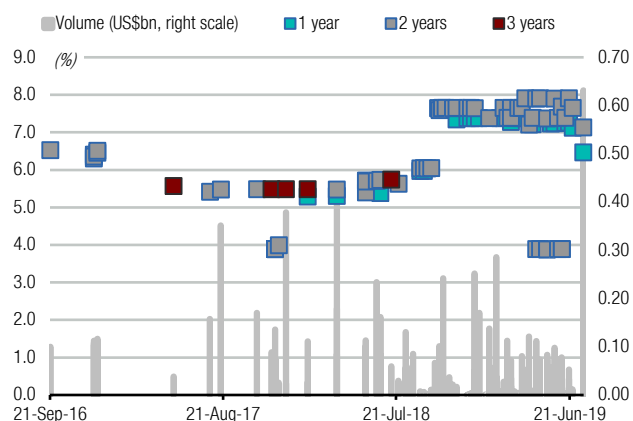
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

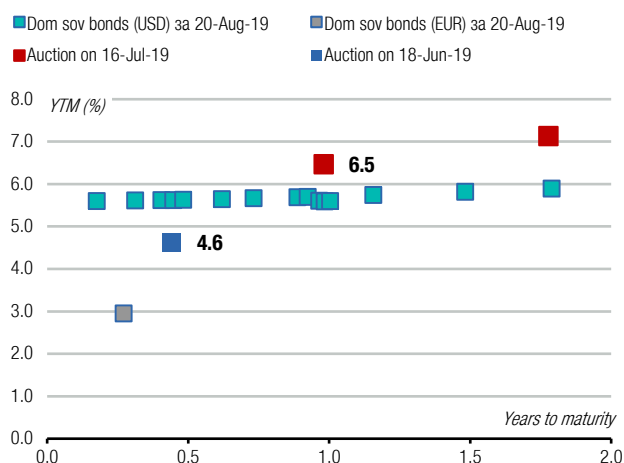
Chart 2. FX-denominated bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: Ministry of Finance of Ukraine, ICU.

Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

Liquidity under pressure from taxes

Last week, outflows from Treasury accounts increased, exceeding budget expenditures. This caused a decline in liquidity below UAH100bn (US\$4bn). We expect it will stay below this level this week.

By the end of last week, liquidity was UAH98.6bn (US\$3.9bn), receiving low support from the NBU via the FX market. Inflows from this source were just UAH1.5bn (US\$0.06bn), while to Treasury accounts, the outflow was UAH6.6bn (US\$0.3bn). Additional inflow came from NBU by increase by UAH0.5bn (US\$0.02bn) of refinancing loans.

The key reason for outflows to budget accounts was quarterly income tax payments. Last Thursday and last Friday, tax authorities received UAH4.3bn (US\$0.17bn) and UAH5bn (US\$0.2bn) of budget revenues respectively, while in first 10-days of the month, they averaged UAH1bn (US\$0.04bn) of daily. Last week, the budget received more than UAH22bn (US\$0.9bn) of revenues, including from tax authorities, which was more than UAH10bn (US\$0.4bn).

ICU view: This week, liquidity will remain under pressure from tax payments. Income tax payments will dominate the first two days, before the budget starts to collect month-end tax payments later. As the result, liquidity will stay below UAH100bn (US\$4bn). NBU will likely be the sole source of liquidity through either the FX market, or by providing banks with new loans.

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Chart 3. Banks reserves usages over last week(UAHm)

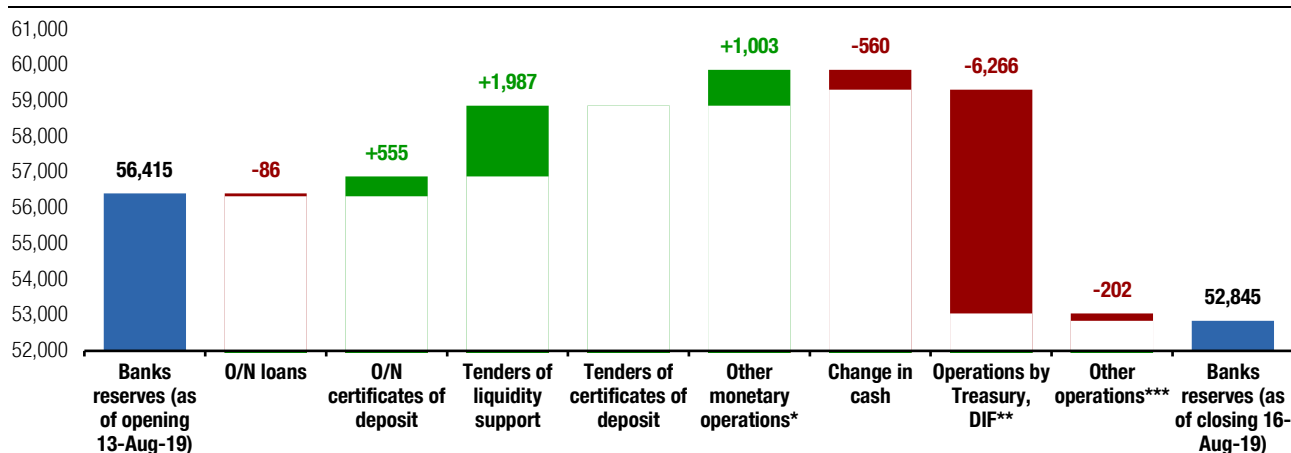
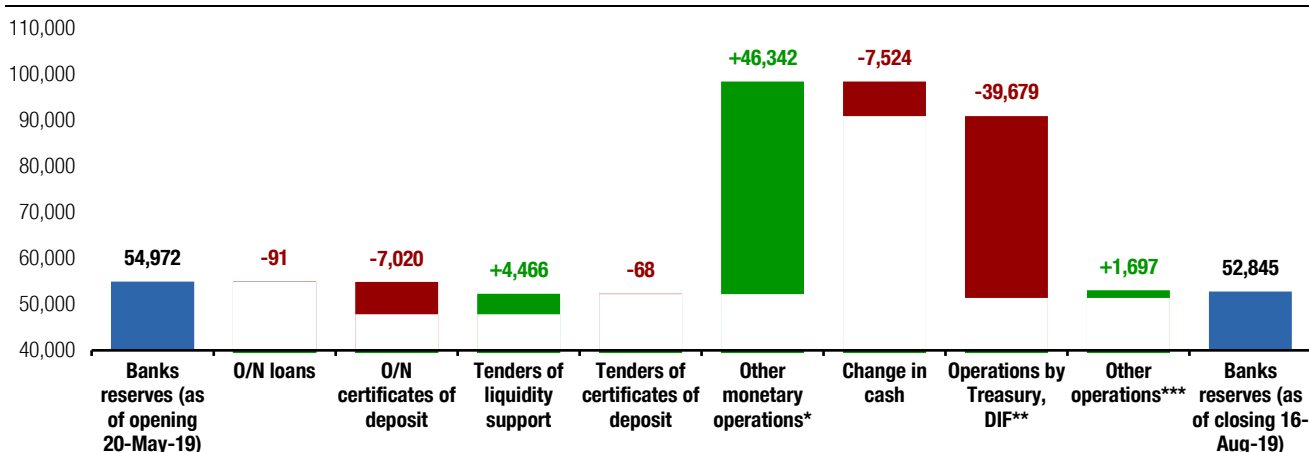


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting https://bank.gov.ua/control/uk/publish/article?art_id=38643651&cat_id=40807142 ;

* operations repo, purchase and sale of government bonds, FX market interventions, stabilisation loans, FX swap agreements; ** DIF – deposit insurance fund;

*** interest payments on NBU's loans and on NBU's certificates of deposit, other operations. Source: NBU, ICU.

Foreign exchange market

Hryvnia holds position

The hryvnia exchange rate continued to be volatile inside the expected range, receiving support from exporters and other Ukrainian companies that sold hard currencies to pay income tax. This week, this source will be replaced by foreign investors when they buy three-year notes, although we doubt this will strengthen the hryvnia significantly. We expect the exchange rate to be largely unchanged within the range of UAH25.1–25.5/US\$

Last week, the hryvnia was supported not only by foreign investors in UAH-denominated debt, but also by locals via the selling of hard currencies to pay quarterly income tax. As a result, the hryvnia strengthened, reaching UAH25.18/US\$ last Tuesday, but on Wednesday, it weakened to UAH25.32/US\$. However, the need for local-currency funds and the NBU's low participation in the FX market caused new appreciation. By the end of the week, the hryvnia appreciated by 0.15% to UAH25.18/US\$. Last week, the NBU purchased only US\$60m from the market.

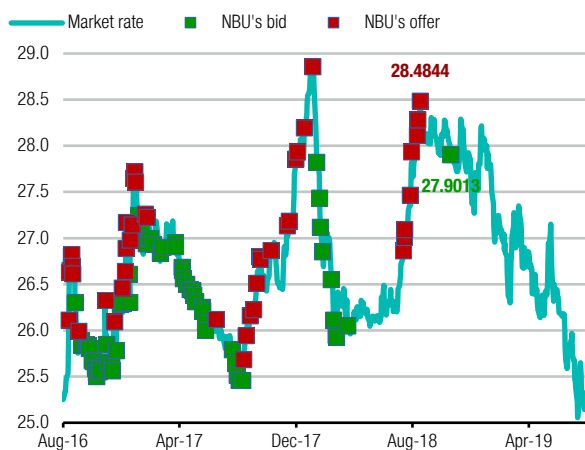
ICU view: *The second half of August can be less stable for the hryvnia, although we do not expect significant weakening. Decline in liquidity and month-end tax payments should increase the supply of hard currencies. Additionally, demand for UAH-*

denominated debt can increase compared with last week, as investors raise funds for the five-year note offering at the end of the month. We anticipate that the hryvnia will be volatile this week inside the UAH25.1–25.5/US\$ range.

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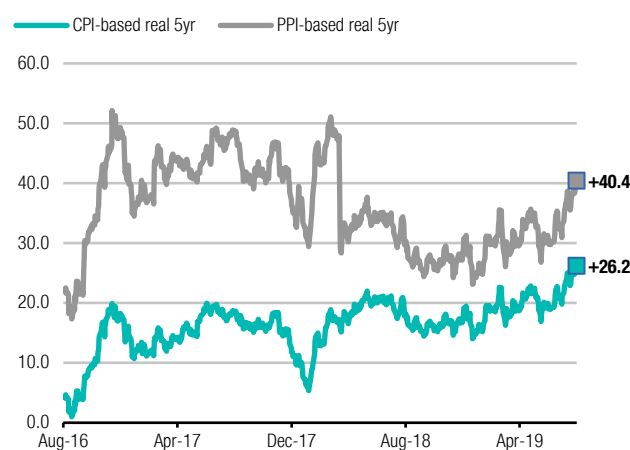
Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market



Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

UAH exchange rate misalignment¹ from fundamental level² (%)



Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

Economics

Real GDP surges 4.6% YoY in 2Q19

2Q19 economic growth was the highest since 4Q16 and beat both our and consensus forecasts. Real GDP growth will slow in 2H19 but will likely exceed our 2019 full-year forecast of 2.7% growth.

Real GDP growth accelerated to 4.6% YoY in 1Q19, up from 2.5% YoY in 1Q18, per preliminary estimate from the State Statistics Service of Ukraine. At the same time, in SA terms economic growth was 1.6% QoQ, the highest growth rate since 4Q13. Detailed information about the main components of the GDP will be released on 18. September.

ICU view: 2Q19 real GDP growth beat both our estimate (+3.3-3.5% YoY) and Bloomberg and Thompson Reuters consensus-forecasts (+2.7% YoY). We expected the acceleration of economic growth in 2Q19 given stronger performance of real sectors of economy last quarter (particularly retail trade and agriculture), but to some extent this should have been offset by greater negative impact from net exports. We estimate that the significant contribution to the 2Q reading made services as consumer confidence in 2Q19 was at the highest since 2013 level. Given better than expected 2Q economic growth and robust consumer demand and confidence, the full-year real GDP growth will likely exceed our current forecast of 2.7% growth even with slower growth in 2H19. Hence, our forecast will be updated after analyzing GDP growth components that will be published by the State Statistics Service on September 18.

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